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No. 89-454

In the Supreme Court of the United States

OCTOBER TERM, 1989

AMOCO PRODUCTION COMPANY, PETITIONER

v.

MANUEL LUJAN, JR., SECRETARY,
DEPARTMENT OF THE INTERIOR, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

KENNETH W. STARR
Solicitor General
RICHARD B. STEWART
Assistant Attorney General
BRIAN J. MARTIN
Assistant to the Solicitor General
ROBERT L. KLARQUIST
WILLIAM B. LAZARUS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether the Department of the Interior acted arbitrarily or contrary to law when it determined that petitioner, a lessee to government-owned mineral rights, had underpaid royalties on gas produced under its lease from 1977 through 1981.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A22) is reported at 877 F.2d 1243. The memorandum ruling of the district court (Pet. App. A23-A34) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 24, 1989. The petition for a writ of certiorari was filed on September 18, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Secretary of the Interior is authorized by the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. 1331 *et seq.*, to grant leases for the recovery of minerals, including oil and gas, from the seabed of the Outer Continental Shelf. 43 U.S.C. 1337 (1982 & Supp. V 1987). The

Act requires the Secretary "to assure the receipt of fair market value for the lands leased and the rights conveyed," 43 U.S.C. 1344(a)(4), and further requires the lessee to pay the government a royalty that relates to "the amount or value of the production saved, removed, or sold." 43 U.S.C. 1337(a)(1)(A). The Minerals Management Service (MMS) administers this program for the Department of the Interior.

The Secretary has issued regulations establishing the standards for determining the "value of production" for royalty purposes. In 1954, the Secretary promulgated a regulation (30 C.F.R. 250.64 (1955)) granting the United States Geological Survey (USGS)[1] broad discretion to determine the "value of production" for royalty purposes:

> The value of production, for the purposes of computing royalty, shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field or area, to the price received by the lessee, to posted prices, and to other relevant matters. * * *

30 C.F.R. 250.64.

The Secretary amended the regulation in 1979 (30 C.F.R. 250.64 (1980)) to state explicitly: (1) that "[t]he value of production shall never be less than the fair market value," as required by the statute; (2) that "the computation of royalty shall be determined by the Director" of MMS; and (3) that the Director "shall consider" certain factors "[i]n establishing value" (*ibid.*).[2] At all times, the

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[1] USGS administered the lease program until that function was transferred to MMS. Pet. App. A6.

[2] The amended regulation stated in full:

> The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be

regulations have set the minimum royalty value as the "gross proceeds" received by the lessee – *i.e.*, the total consideration. The regulations, however, allow the Director of MMS to determine that the "value of production" for a particular lease is higher than the lessee's gross proceeds. The Director may set a higher value by considering, among other things, the prices paid for like-quality products from the same field or area.

Lessees must "file with the Director, within 30 days after their effective date, a copy of all contracts * * * for the disposal of lease products." 30 C.F.R. 210.150 (1983). Lessees pay royalties on a monthly basis, 30 C.F.R. 218.50, but those payments are subject to a later audit by MMS's Royalty Compliance Office. 30 C.F.R. 217.200 (1983).

2. Petitioner owns a 50% share of the gas produced under a lease entered into with the United States in 1970 and called Lease OCS-G 1972 (Lease 1972). Pet. App. A6, A25-A26. In August 1972, petitioner filed with USGS copies of a gas-purchase contract between petitioner and Columbia Gas Transmission Corporation. *Id.* at A6-A7. Petitioner's accompanying letter explained that the agreement covered sales from Lease 1972, and stated that peti-

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determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

30 C.F.R. 250.64 (1980). The regulation was redesignated in 1983 as 30 C.F.R. 206.150, and has since been modified in ways unrelated to this case.

tioner "dedicate[d]"[3] its share of gas produced under the lease to Columbia Gas. Admin. Rec. tab 37, Exh. C.

The USGS Supervisor then sent petitioner a letter (Pet. App. A19) acknowledging receipt of petitioner's contract with Columbia Gas and stipulating that "[p]ayment on the gas for royalty purposes shall be based on the field delivery volume times the [Federal Power Commission]-approved price, or a higher price, if received."[4] In February 1973, petitioner again wrote the USGS Supervisor: (1) to explain that the company had committed half of its 50% share to Columbia Gas but that the remaining gas was uncommitted, and (2) to seek the Supervisor's approval that royalties be not less than the volume of gas produced multiplied by the FPC-approved price, or a higher price if received. Admin. Rec. tab 35, Exh. L. The Acting Supervisor approved that method of valuation. Pet. App. A20-A22.

Until 1977, petitioner sold its entire share of Lease 1972 gas to Columbia Gas. Pet. App. A7. Petitioner paid

[3] "Dedicates" is a term of art in oil and gas purchase agreements, and is used in contrast to the term "warrants." Sales are most commonly made pursuant to a "dedication" or "commitment" contract like that between petitioner and Columbia Gas, in which the producer/seller identifies a particular source – here, Lease 1972 – that will be used to fulfill the contract for its full term. That source is then said to be dedicated or committed to that contract. A warranty contract, in contrast, is one in which the producer/seller agrees to provide a certain volume of product to the buyer over the life of the contract, *i.e.*, warrants that such volume will be provided, but does not specify the source or sources of the product to be provided. Accordingly, the producer/seller is free to fulfill a warranty contract from whatever source or combination of sources it chooses.

[4] Section 7 of the Natural Gas Act, 15 U.S.C. 717f, required that the Federal Energy Regulatory Commission (formerly the Federal Power Commission (FPC)) approve such gas sale contracts and prices, through issuance of a certificate of public convenience and necessity. 15 U.S.C. 717f(c).

royalties based on the Columbia Gas contract price (*ibid.*), and those royalty payments are not at issue here. From September 1977 to October 1981, however, petitioner sold its entire share of Lease 1972 gas to Florida Gas Transmission Company. *Id.* at A8, A27. Petitioner sold that gas under a warranty contract with Florida Gas that had been executed in 1964. For this period, petitioner made royalty payments on the basis of the Florida Gas contract price, which was substantially lower than the Columbia Gas contract price. *Id.* at A8. The Department was not notified of petitioner's decision to sell Lease 1972 gas under the Florida Gas contract. *Id.* at A16.[5]

The MMS Royalty Compliance Office audited petitioner's royalty payments for the years 1977 to 1981 and concluded that petitioner should have paid royalties based on the Columbia Gas contract price, not the Florida Gas contract price. Pet. App. A8. MMS gave two reasons for its decision: (1) the government's initial royalty valuation for Lease 1972 was made in connection with the Columbia Gas contract, and (2) petitioner had never sought any royalty valuation in connection with sales of Lease 1972 gas to Florida Gas. *Id.* at A47-A48. On appeal, the Director of MMS affirmed the Compliance Office's decision. *Id.* at A51.

Petitioner appealed the Director's decision to the Interior Board of Land Appeals. The Board affirmed the

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[5] Although a copy of the Florida Gas contract had been sent to USGS in 1966 (Pet. 6), that submission did not specify Lease 1972 as a source for gas under that contract because that letter predated Lease 1972 by four years. By letter of January 14, 1977, petitioner requested a royalty payment procedure for production from three other leases identified as providing gas for the Florida Gas contract. See Pet. 8; Admin. Rec. tab 37, Exh. E. However, no such letter was sent to MMS that identified Lease 1972 as an intended source for the Florida Gas "warranty" contract.

Director's determination that petitioner had underpaid its royalty obligation. Pet. App. A36-A61. In its opinion on reconsideration, the Board interpreted the applicable regulation, 30 C.F.R. 250.64 (1980), as vesting in MMS alone the authority to find "the value of production" from a specific lease. Pet. App. A40. The Board stated that such authority cannot be granted to the lessee. *Ibid.* The Board therefore reasoned that the royalty-valuation letters in this case bound the parties only insofar as they reflected a proper exercise of regulatory authority; thus they could not be construed in a way that would result in a delegation to petitioner of the authority to set the value of gas produced under Lease 1972. *Ibid.*

The Board accordingly rejected petitioner's proffered construction of the royalty-valuation letters that would have given petitioner the power to select the Florida Gas contract price as the "value of production" for the years 1977 through 1981. Pet. App. A40. And the Board concluded that the Director's selection of the Columbia Gas contract price for the years in question was a permissible exercise of the Director's discretion. *Id.* at A42-A43.

3. Petitioner then brought this suit challenging the Board's decision. The district court, performing the limited review authorized by the Administrative Procedure Act, 5 U.S.C. 706, reviewed the record and concluded that the Board's decision had "a rational basis" and was not a "clear error." Pet. App. A33. Thus the court granted the government's motion for summary judgment. *Id.* at A35.

4. The court of appeals affirmed. Pet. App. A1-A19. It held that "the Board acted within its authority by concluding that federal regulations prohibited the federal official charged with responsibility for valuing gas from delegating the authority to do so, and by further concluding that the construction of the [valuation] letters contended for by [petitioner] would involve such a delegation." Pet. App. A2. The court therefore held that

the Director of MMS retained the authority to determine the value of the disputed gas production, and that the valuation itself "was a reasonable exercise of his discretion." *Ibid.*

ARGUMENT

The decision of the court of appeals is correct, and it does not conflict with the decisions of any other court. Thus no further review is warranted.

1. Petitioner's main contention (Pet. 13-21) is that the court of appeals erred by condoning "the Department's retroactive application of a new interpretation of the pertinent statutes and regulations." Pet. 17. But this is not a case of retroactive application of the Department's regulations. The Department had never before faced the question presented by this case; and it most definitely had never before permitted the result that petitioner wished to obtain. This is the first time that the Department has been required to construe its own regulations to determine whether MMS must decide the value of production under a lease, or whether the Department may (as petitioner contends) delegate that function to the lessee. The Department determined that, under 30 C.F.R. 250.64 (1980), MMS must make that finding. Hence, the only question presented is whether the Department's interpretation of its own regulations should be set aside.

The court of appeals, of course, properly deferred to the Department's view of its own regulation. It is well settled that "[i]n construing administrative regulations, 'the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous * * *.' " *United States* v. *Larionoff*, 431 U.S. 864, 872 (1977). See also *INS* v. *Stanisic*, 395 U.S. 62 (1969).

Here, the court of appeals correctly held (Pet. App. A16) that the Board's interpretation of the Department's regulation was reasonable.

The Outer Continental Shelf Lands Act requires that lessees pay royalties based on "the amount or value of the production saved, removed, or sold." 43 U.S.C. 1337(a)(1)(A). And the Department's applicable regulation under the Act, 30 C.F.R. 250.64 (1980), states that such "value of production" for royalty valuation purposes "*shall* be determined" by the Director of MMS, on the basis of a specified list of factors, including the highest price paid for like-quality gas from the same field (emphasis added). Accordingly, the Board reasonably concluded that, under the Department's regulation, only the Director of MMS has the authority to determine the "value of production" under a lease; that task cannot be delegated to the lessee when it decides how to dispose of its gas.[6]

At bottom, petitioner's claim appears to be based on estoppel principles—*i.e.*, that the government's valuation letters led petitioner to believe that it could pay royalties under the 1972 Lease on the basis of *any* FPC-approved price. At the time the Department issued its valuation letters, however, petitioner had not submitted the Florida Gas contract to the government. As the court of appeals recognized (Pet. App. A16-A17), therefore, this is not a case where the Department made an informed and responsive valuation decision and, later, tried to change that decision.

2. Contrary to petitioner's suggestion (Pet. 18-19), the Department did not act arbitrarily or abuse its discretion in selecting the Columbia Gas contract price as the value

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[6] Under petitioner's construction of the valuation letters, petitioner could control the determination of the "value of production" by choosing to sell Lease 1972 gas under any of its many FPC-approved warranty contracts.

of production under Lease 1972. The Florida Gas contract was never designated by petitioner as being applicable to Lease 1972. The only contract so designated was petitioner's contract with Columbia Gas. Petitioner was not contractually bound to sell Lease 1972 gas at the Florida Gas contract price, nor was petitioner bound to sell the gas to Florida Gas at all.

For reasons of its own, petitioner chose to use Lease 1972 gas to fulfill an old contractual obligation to Florida Gas. But unlike the Florida Gas contract, the Columbia Gas contract specifically pertained to gas produced under Lease 1972 and represented market conditions related to Lease 1972's operations. See Pet. App. A59. Thus, MMS did not abuse its discretion in selecting the Columbia Gas contract price as representing the value of production under Lease 1972 for years 1977 through 1981.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

RICHARD B. STEWART
Assistant Attorney General

BRIAN J. MARTIN
Assistant to the Solicitor General

ROBERT L. KLARQUIST
WILLIAM B. LAZARUS
Attorneys

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